

Economic Problems of Accidents and Compensation

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Over the past 30 years there have been enormous changes in the understanding of the economic effects of accident law. I believe that over the next decade there will be equally increased attention to the economic dimensions of the design of compensation systems.

All are aware of the strict liability revolution and the substantial expansion of liability that has occurred in the United States led by changes in the products field with the expansion of substantive liability and the reduction of defenses available against alleged tortfeasors. This change in approach toward the law, however, has extended far beyond products liability and has affected many other areas. It has affected insurance law and insurance interpretation. It has affected the interpretation of statutes of limitation. It has affected the way courts deal with expert testimony and with damages issues. It is a movement that is far more extensive than simply products liability alone, though, I believe that it was led by developments in products liability.

Within the products liability field, the movement was encouraged by the economic idea that greater liability would lead to salutary effects, both in terms of deterrence and in terms of providing compensation. Over the last 30 years, however, there has been a substantial re-analysis of those conclusions in the academic literature in the United States. The academic literature today is substantially different than what it was 30 years ago.

Thirty years ago there was a debate, a very serious and far ranging debate, over the relevance of economics in any form for the analysis of the tort system. We all are familiar with the debate between Calabresi and Blum and Kalven, the very substantial challenge that George Fletcher gave to the economic approach to the legal system in his corrective justice article and, of course, Richard Posner's extensive work claiming that tort law is, will be, and should be efficient in all of its forms.

Again, that was a debate as between deterrence and compensation and, indeed, many still view these two approaches toward the legal system as alternatives in some way. I think it is characteristic of that time that the efficiency/compensation question was regarded as a debate or as alternative goals of the legal system that were inconsistent in some way.

A newer economic analysis — and perhaps I should say a softer economic analysis to distinguish it from Richard Posner's work — is reflected in the ALI report and in its conclusions that Gary presented just a moment ago. It is also reflected, perhaps, in a slightly more aggressive form, but I think an important form politically, in the recommendations of Vice President Quayle's Council on Competitiveness which has recently recommended and sent to Congress some broad-ranging changes, not so much in substantive law but in procedure and in the award of attorney's fees, that are meant to deal with perceived problems in the expansion of the law.

We also see a new thinking and a new approach to this area of the law in the adoption of the product liability directive by the European commission and by a number of countries in Europe. And, of course, the Japanese are very interested in the European directive and in developments in the United States as to how to change their law.

These new approaches to tort law and to accident law and compensation systems are not entirely the result of new academic learning. The academic learning has trailed behind broader trends that have pressed in these directions.

Indeed, I think the most important force for the re-analysis of accident law and compensation systems is the great increase in international trade and the increased concern about international competitiveness. I think that these concerns are important for understanding the movement in Europe and also important for understanding Japan's desire to choose a system of product or, more broadly, accident law, that corresponds to that of western countries.

Most important for understanding the future of accident law and the future of compensation law is to try to understand what the effects will be of the greater harmonization of law across different jurisdictions. The academic literature in the United States has operated for at least the last 30 years and probably 200 years as if the United States were an island alone and could ignore the law prevalent in other countries. There has always been some comparative work, but the work of comparativists, I think, has had less influence in the United States than in any other country. I believe that that will change very substantially in the future.

The compulsion to harmonize accident law and the design of compensation systems across countries will necessarily lead to a greater focus on the economic effects of accident law and what I will call the economic definition of compensation systems.

For this analysis, I wish to put aside the economic efficiency school of Richard Posner and the Chicagoans. The focus on economic efficiency is useful to an economist because one can frame the issue in a mathematical model, and then play with the model. But the economic efficiency approach is not very useful in thinking about a legal system, and it is not very useful in trying to either describe to judges or to juries how to think about the law. The ALI report has avoided the economic efficiency approach almost entirely, though I think there is a very important economic thrust to the ALI report.

When I use the term "economics" or "economic effects," I mean a generalized cost-benefit approach toward the design of accident law or the design of compensation systems: that is, weighing to the best ability that one can what the costs are of a particular rule or of a particular design of a compensation system against some definition of the benefits of the law or system.

My point today is that there are two principal reasons that greater international trade and the greater desire for harmonization of law across countries will lead toward the expanded influence of the economic approach to the design of accident law and of compensation systems. The first reason is that the desire to harmonize law across jurisdictions necessarily challenges the individual idiosyncratic moral or non-economic, non-functional features, of any country's legal system. Indeed, that is what harmonization means. It means putting the idiosyncratic aside and trying to reach a definition of law or a definition of a set of standards that operates roughly equivalently across different jurisdictions.

Necessarily that means a shifting to a functional approach of thinking about the law. That is, it simply is no longer possible for a country in the European commission to presume to be perfecting some nationally idiosyncratic corrective justice view of some principle of law if the other countries in the European community are taking a functional approach to the law. Thus, the nationally idiosyncratic will be harmonized out of each country's legal system.

In addition, it follows that if the moral or distinctively national approach to legal principles is abandoned, what is left will be a functional approach to law. It also follows, therefore, that a shift toward a functional approach means a shift toward taking the economic effects of the legal system and of the system of law into account.

The second reason that I believe that there will be an increased influence of economic analysis of the effects of the legal systems derives from the increased competitiveness of trade across jurisdictions.

There is no question that, with the success assumed to be achieved of the 1992 movement in Europe, with the tremendous success that the Japanese have achieved in entering foreign trade, that there will be pressure toward efficiency, pressure toward having a legal system that controls the manufacture of products or the provision of services in international commerce that does not put excessive burdens on one particular country versus another.

There are very few studies in the United States today about the effects of modern tort law or products liability law on international competitiveness. The reason for that is that we have not yet had a harmonization of litigation.

The American trial bar has not yet exploited and uncovered the reservoir of victims that have purchased American products and been injured by them in foreign countries. When the American trial bar develops that market for litigation, then there will quickly be greater attention given to the effects of U.S. product liability law on the international competitiveness of United States' manufacture. That attention will create pressure toward a more economically rational form of law.

I will not at this point even try to define what "economically rational" means. But I think that the increased pressures of international trade will necessarily force each country to examine whether its system of law and the extension of its system of law to its manufacturers and providers of services benefits or harms them competitively.

Of course, the foreign trade in any country is a relatively small portion of the total gross national product. But it is not insignificant. And with increased competition and increased international trade, there will necessarily be increased attention toward the economic effects of the legal system.

What will increased attention to economic effects mean about the direction of a legal system? What does it imply about substantive changes in the law? How should we think about the traditional economic debate between deterrence and compensation?

There is close to a consensus among those writing about the economic effects of law that, from an economic standpoint, an economically sufficient accident law or tort law — whether product liability, auto, or workers' compensation — can be defined in very simple terms. If the tortfeasor were able to prevent the accident in some practicable

way but did not do so, then the tortfeasor ought to be held liable; otherwise, not. That is a very simple economic definition of "optimal or efficient" accident law. I believe that it represents a consensus definition.

Regrettably, though there are many admirable achievements of Richard Posner, he has captured the words "efficient and optimal" and put his own definition upon them which is not a definition that is always helpful.

Posner aside, however, an economically sufficient accident law or tort law could be defined simply as I have defined it above. Most importantly, the forces of harmonization and increased competitiveness of international trade will press the legal system of each jurisdiction's legal system in the direction of that economic definition of accident law.

For example, the reform movement in the United States is pressing in that direction. Similarly, the European Products Liability Directive, though it adopts the term "strict liability," really seems to be designed to be interpreted according to this economic definition, rather than in the manner that the term "strict liability" is interpreted in the United States.

Furthermore, I think that these trends in the legal systems of Europe and the U.S. will successfully lead toward a unified approach toward tort law, where the principal ambition of tort law will be to make liable those tortfeasors who could have prevented an accident but failed to do so.

What about compensation systems? Parallel to the expansion of tort law in the United States, there has been expanded concern about providing compensation to the injured. I have argued in my work, though it has not been totally accepted, that the principal source of the expansion of liability in the United States beyond the point of minimal economic sufficiency, has been a desire to compensate. Whether that is true or not, there is no question that there has been a substantial increase in concerns about compensation.

In my view, there will be greater international competition in the future in terms of the design of compensation systems. Every country has a compensation system of some form. These compensation systems will be subjected to increased competition. The reason derives from issues of international finance.

The first arena of battle in all international financial competition is the level of taxation of any country. The taxation level of a country is heavily influenced by the form of compensation system that the country

provides. We have seen extraordinary competition over the last decade in terms of tax levels, which has had a substantial effect on the design of compensation systems.

Everyone is aware that every country in the world has experienced substantial reduction in taxes over the last ten years. While there have been internal political pressures to reduce taxes, there have also been international trade reasons to reduce them because countries compete as sources of manufacture and as sources of employment. We have also seen over the past decade that the reduction in taxes has not been matched by reductions in government expenditures in any country in the world. Almost every country in the world has suffered increasingly severe budget deficits. These deficit problems have affected, and necessarily will in the future affect, compensation systems and the design of compensation systems within any country. Indeed, if we look around the world, there has not been any health or accident compensation system anywhere that has not been subjected to severe financial pressures as a consequence of the reduction in taxes and the consequent deficits.

Though it operates through a different mechanism, I believe that these increased financial pressures on compensation systems will also increase the attention to and the relevance of economic analysis and the economic approach toward the law. The process is very simple. The desire of every compensation system is to provide the most extensive compensation possible given the resources available, and to provide that compensation most effectively to those that are injured or that suffer loss.

These are essentially economic goals. Essentially all that economics is about is the allocation of resources in the presence of scarcity. There is no question that all compensation systems of the world suffer problems of the scarcity of compensation resources. Moreover, the policymakers of every country in the world would like to provide more extensive compensation than is currently being provided.

The resolution of these concerns, ultimately, will be reflected in greater harmonization of compensation systems across countries, both from the desire for harmonization, but also from concerns about competitiveness.

The pressures to reduce taxes are serious. Pressures at the same time to remain competitive in foreign trade are serious to the extent that overall taxes in an economy can be lowered by adjustments in a country's compensation system. Put differently, to the extent that compensation can be provided equally extensively at less cost to the

productive elements of an economy, the more competitive the country becomes.

Now, of course, the central problem in dealing with compensation systems, and I think the most important problem in the United States, is how to deal with the poor. In this regard, the U.S. has experienced, if anything, a free ride in terms of competitiveness in international trade because it provides a relatively low level of support for the poor, which as a consequence gives the United States and United States' manufacturers what might be regarded as an unfair competitive advantage. The United States has a compensation system for the poor. It differs in extensiveness in different states, heavily funded by the federal government, and with additional public assistance provided by state jurisdictions. Nevertheless, the overall level of support is low. Still there is a limit to the extent to which even the U.S. will disregard the poor.

There is little chance whatsoever that greater concerns about international competitiveness will lead us to abandon that low level of support for the poor. Indeed, I think that the greater pressures toward harmonization across countries will lead in the opposite direction.

Yet there are limits to the extent to which any country can provide compensation to those injured or suffering. I believe over the next years that we will see severe challenges to the comprehensiveness of national compensation systems, such as the New Zealand system or to systems proposed by my friend, Professor Sugarman, or others. These challenges will stem from the precarious economic positions of many countries.

I think that the effort to provide uniform compensation without regard to tort law or accident law in the New Zealand manner will not be successful in the future. Indeed, I believe that there are strong pressures to move back toward reliance on accident law.

Accident law is a very effective way to reduce the costs of a compensation system. Accident law shifts losses to tortfeasors and, more precisely, shifts losses to tortfeasors where the tortfeasor is able to prevent the loss.

In the debate between compensation and deterrence, some have argued that, since every humane person wants compensation to be provided to injured persons, and since we do not know definitively whether the legal system has a deterrent effect, we should forget about deterrence and adopt a compensation rationale in order to provide compensation most broadly.

I believe that this approach addresses the problem backwards. If we view a compensation system as my Dean and friend Guido Calabresi

has taught us — as a form of tax system — and if a country faces a need to lower the general tax burden — whether a political desire or a desire that has been put to the country by greater international competition — and if that country is considering reducing the level of compensation it provides to injured persons, then why not first shift compensation costs where they might have some deterrent effect? That is, whether there is definitive evidence of a deterrent effect is not an argument to ignore deterrence, especially where compensation systems face severe financial pressures.

I think, however, that there is evidence, scattered though it is, that there is some substantial deterrent effect of accident law, not only in the products field, but also in the auto field and in workers' compensation. There is enough evidence that tort law has some form of deterrent effect to employ tort law as a means of making a country's compensation system more generous. That is, take away from a compensation system those sets of injuries caused in contexts in which the tortfeasor could have prevented the injury. Make the tortfeasor pay for those directly. If you view a compensation system as a tax system, apply the tax first to tortfeasors in contexts that free resources to allow broader compensation elsewhere.

Indeed, over the next decade in the United States, we will see even a retreat from the workers' compensation that Gary referred to as a system that works pretty well. I think that everybody believes that it works fairly well. But there are increased pressures in the United States to reduce the costs of workers' compensation. There are very few state legislatures in the United States that do not consider some form of workers' compensation reform package every year, addressing the increasing costs of insurance or of workers' compensation judgments.

An obvious reform in that context — an obvious and compelling way to reduce the general costs of workers' compensation — is to eliminate the limit on suing the employer where the employer could have prevented the accident. Take those costs out of the insurance system, place them on the employer. It may have a deterrent effect.

There is substantial evidence, in fact, that, to the extent insurers can increase premiums to employers who have substantial claims, premium increases lead to changes in employers' activities and reduce the accident rate. Such reductions will increase the ability of any system to provide compensation more broadly to those workers who are injured in contexts in which the accident was unpreventable. Thus, I believe that the trend for the future will not be toward the greater application of workers' compensation concepts barring suit against tortfeasors, but

the reverse: the re-introduction of tort law into the workers' compensation area.

Finally, I believe that these various trends — the desire for greater harmonization of the law across countries, the increased competitiveness as a result of increased foreign trade and, again, the financial pressures on compensation systems resulting from lower levels of taxes and increased budget deficits — all of these developments will lead to a greater attention to economics — to the economic effects of accident law and to the design of the economically optimal compensation systems.

Again, the essence of economics is how to obtain the greatest return from a limited set of resources. The increased competitiveness of foreign trade and the budget deficits of every country certainly show us that resources are limited. The question that remains is how then to define an accident law system and a compensation system to take best advantage of those limited resources.